
352. INTEREST EXPENSE

352. INTEREST EXPENSE

C. BORROWER-LENDER RELATIONSHIP.

1. To be allowable, interest expense shall be incurred on indebtedness established with lenders or lending organizations not related through control, ownership or personal relationship to the borrower. Presence of any of these factors could affect the "bargaining" process that usually accompanies the making of a loan, and could thus be suggestive of an agreement on higher rates of interest or of unnecessary loans. Loans shall be made under terms and conditions that a prudent borrower would make in arms-length transactions with lending institutions. Thus, interest paid by the facility to partners, stockholder, or related organizations of the facility shall not be allowable.

352. INTEREST EXPENSE

352. INTEREST EXPENSE

2. Exceptions to the general rule regarding interest on loans from controlled sources of funds are made in the following circumstances. Interest on loans to those facilities classified as Intermediate Care Facilities prior to October 1, 1990, by partners, stockholders, or related organizations made prior to July 1, 1985 shall be allowable as cost, as determined under these principles, provided that the terms and conditions of payment of such loans have been maintained in effect without subsequent modification subsequent to July 1, 1975. For facilities classified as Skilled Facilities prior to October 1, 1990, the same policy applies for this type loan made prior to and maintained without modification subsequent to December 1, 1979. If the general fund of a provider "borrows" from a donor-restricted fund and pays interest to the restricted fund, this interest expense is an allowable cost. The same treatment shall be accorded interest paid by the general fund on money "borrowed" from the funded depreciation account of the provider or from the provider's qualified pension fund. In addition, if a facility operated by members of a religious order borrows from the order, interest paid to the order shall be an allowable cost.

352. INTEREST EXPENSE

352. INTEREST EXPENSE

3. If funded depreciation is used for purposes other than improvements, replacement, or expansion of facilities or equipment related to patient care, allowable interest expense shall be reduced to adjust for offsets not made in prior years for earnings on funded depreciation. A similar treatment shall be accorded deposits in the provider's qualified pension fund where such deposits are used for other than the purposes for which the fund was established.

If a facility is sold and the funded depreciation account is not transferred to the purchaser, the earnings of the funded depreciation account shall be treated as an investment income. Any investment income that had been earned by the funded depreciation account and had not been utilized to reduce interest expense, shall be considered an overpayment by the Medicaid Program and a retroactive cost settlement shall be computed at the time of the sale. If the funded depreciation account is transferred to the purchaser and the purchaser eliminates the account, any investment income earned in prior years by the account shall be offset against interest expense of the purchaser.

352. INTEREST EXPENSE

352. INTEREST EXPENSE

D. INTEREST NOT REASONABLY RELATED TO PATIENT CARE

Interest expense is not reasonably related to patient care if:

1. It is paid on borrowings in excess of the allowable basis of the asset.
2. It is made to defer principle payments.
3. It is used to purchase goodwill or other intangible asset.
4. It is in the form of penalty payments.

E. INTEREST EXPENSE ON PURCHASES OF FACILITIES ON OR AFTER

JULY 18, 1984. For facilities purchased on or after July 18, 1984, but before October 1, 1985, the amount of interest expense allowed to the purchaser shall be limited to the amount that was allowable to the seller at the time of the sale. For

352. INTEREST EXPENSE

352. INTEREST EXPENSE

facilities purchased on or after October 1, 1985, the amount of interest expense allowed to the purchaser shall be limited to the interest on the allowable basis of the asset reduced by the amount necessary (if applicable) to ensure that the increase in depreciation and interest paid to facilities purchased on or after October 1, 1985 does not exceed \$3,000,000 annually. Any reduction of allowable interest based on the \$3,000,000 limit shall be prorated proportionately among the affected facilities (i.e., the percentage reduction shall be applied equally.)

353. FACILITY LEASE OR RENT ARRANGEMENTS

353. FACILITY LEASE OR RENT ARRANGEMENTS

- A. For nursing facilities previously classified as Intermediate Care Facilities, the allowable cost of all lease or rent arrangements occurring after 4/20/76 shall be limited to the owner's allowable historical costs of ownership. The effective date of this limitation for nursing facilities previously classified as Skilled Nursing Facilities is 12/1/79. Historical costs of ownership can include the owner's interest expense, depreciation expense, and other costs such as taxes, insurance, maintenance, etc. In the event of the sale or leaseback arrangement, only the original owner's allowable basis shall be recognized.

The owner's allowable historical cost shall be subject to the basis limitations as applied to property owned by providers. Additionally, allowable depreciation and interest shall not exceed that which would have been allowed had the assets been owned by the provider.

In order to have the allowable cost determined and approved, all data pertaining to the lease or rent arrangement, including the name of previous owners, shall be submitted by the provider.

Page 353.01

TN # 96-10Approved MAY 16 2001Eff. Date 7-1-96

Supersedes

TN # 90-6

353. FACILITY LEASE OR RENT ARRANGEMENTS

353. FACILITY LEASE OR RENT ARRANGEMENTS

In regard to lease or rent arrangements occurring prior to 4/20/76 for basic Intermediate Care and 12/1/79 for Skilled Nursing, the Medicaid Program shall determine the allowable costs of such arrangements based on the general reasonableness of costs.

- B. Lease or Rent arrangements for land only shall be considered an allowable cost if the lease agreement does not contain an option to purchase at less than market value. If the lease amount is a set amount each year, the lease amount should be reclassified to the Depreciation Expense cost center. If the lease amount varies from one (1) year to the next, the lease amount shall be reclassified to the Operation and Maintenance of Plant cost center.

354. CAPITAL LEASES

354. CAPITAL LEASES

Leases determined to be Capital Leases under Generally Accepted Accounting Principles (GAAP) shall be accounted for under the provisions of GAAP. However, all basis limitations applicable to the depreciation and interest expense of purchased assets shall apply to Capital Leases.

Department for Medicaid Services
Cost Principles

Nursing Facilities Reimbursement Manual

355. AMORTIZATION OF ORGANIZATION AND START UP COSTS

355. AMORTIZATION OF ORGANIZATION AND START-UP COSTS

Organization and start-up costs as defined in Health Insurance Manual 15 shall be
amortized in accordance with the provisions of Health Insurance Manual 15.

Page 355.01

TN # 96-10

Supersedes

TN # 90-6

Approved MAY 16 2001

Eff. Date 7-1-96

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

To encourage facilities to refinance loans for long term debt in existence on December 1, 1992 at lower interest rates and for shorter durations than their current financing, the Kentucky Medicaid Program shall allow an increase in depreciation expense equal to the increased principal payments (principal payments on the allowable portion of the loan under the new financing minus the principal payments under the old financing on the allowable portion of the loan). However, this increase in allowable depreciation expense shall not exceed the reduction in allowable interest expense which results from the refinancing. Interest savings for any period shall be computed as follows: allowable interest expense which would have been incurred under the previous loan, plus allowable amortization of financing costs which would have been incurred under the previous financing arrangement, minus allowable interest expense under the new financing arrangement, minus allowable amortization of loan costs under the new loan (including any unamortized loan expense from the previous loan.) Total depreciation allowed (including the additional depreciation) shall reduce the allowable depreciable basis of the

Page 356.01

TN # 96-10

Supersedes

TN # 92-24

Approved MAY 16 2001

Eff. Date 7-1-96

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

building. Total depreciation expense allowed over the lives of the assets that make up the facility shall not exceed the allowable undeprciated basis of the building. The additional depreciation allowed by the provision shall first be applied against the allowable basis of the longest lived asset which has any remaining allowable undeprciated basis. The remaining allowable undeprciated basis of the facility at the end of the refinanced loan, shall be depreciated over the remaining useful lives of the assets utilizing straight line depreciation.

If subsequent to the refinancing and claiming of accelerated depreciation, the facility is sold (either the operating entity holding the nursing facility licensure or the building on which the accelerated depreciation is claimed) or the facility voluntarily discontinues participation in the Medicaid Program, the following recapture provisions shall be applied:

1. The owner who claimed the accelerated depreciation shall pay the Medicaid Program an amount equal to the difference in depreciation claimed for the certified nursing facility with and without the accelerated depreciation times the average Medicaid percentage of total occupancy in the certified nursing facility.

Page 356.02

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

356. ACCELERATED DEPRECIATION TO ENCOURAGE REFINANCING

2. If the facility remains in the Medicaid Program, the allowable depreciable basis for the new owner shall be the allowable depreciable basis had the prior owner never utilized accelerated depreciation for Medicaid reimbursement.

360. BAD DEBTS,. CHARITY AND COURTESY ALLOWANCES

360. BAD DEBTS, CHARITY, AND COURTESY ALLOWANCES

- A. PRINCIPLE. Bad debts, charity, and courtesy allowances are deductions from revenue and shall not be included in allowable cost.
- B. DEFINITIONS.
1. Bad Debts. Bad debts are amounts considered to be uncollectible from accounts and notes receivable which were created or acquired in providing services. "Accounts receivable" and "notes receivable" are designations for claims arising from the rendering of services, and are collectible in money in the relatively near future.
 2. Charity allowances. Charity allowances are reductions in charges made by the provider of services because of the indigence or medical indigence of the patient.

360. BAD DEBTS,, CHARITY AND COURTESY ALLOWANCES

360. BAD DEBTS, CHARITY, AND COURTESY ALLOWANCES

3. Courtesy Allowances. Courtesy allowances indicate a reduction in charges in the form of an allowance to physicians, clergy, members of religious orders, and others as approved by the governing body of the facility, for services received from the facility. Employee fringe benefits, such as hospitalization and personnel health program, shall not be considered to be courtesy allowances.

C. NORMAL ACCOUNTING TREATMENT - REDUCTION IN REVENUE.

Bad debts, charity, and courtesy allowances represent reductions in revenue. The failure to collect charges for services rendered does not add to the cost of providing the services. These costs have already been incurred in the production of the services.

- D. CHARITY ALLOWANCES. Charity allowances have no relationship to recipients of the Medicaid Program and shall not be allowable costs.

361. COST OF EDUCATIONAL ACTIVITIES

361. COST OF EDUCATIONAL ACTIVITIES

A. PRINCIPLE. An appropriate part of the net cost of approved educational activities shall be an allowable cost.

B. DEFINITIONS.

1. Approved Educational Activities. Approved educational activities means formal organized or planned programs of study usually engaged in by providers in order to enhance the quality of patient care in a facility. These activities shall be licensed where required by state law. If license is not required, the facility shall receive approval from the recognized national professional organization for the particular activity.

2. Net Cost. The net cost means the cost of approved educational activities (including stipends of trainees, compensation of teachers, and other costs), less any reimbursements from grants, tuition, and specific donations.

361. COST OF EDUCATIONAL ACTIVITIES

361. COST OF EDUCATIONAL ACTIVITIES

3. Appropriate Part. Appropriate part means the net cost of the activity apportioned in accordance with the methods set forth in these principles.

C. ORIENTATION AND ON-THE-JOB TRAINING. The costs of "orientation" and "on the job training" shall not be within the scope of this principle but shall be recognized as normal operating costs.

362. RESEARCH COSTS

362. RESEARCH COSTS

- A. PRINCIPLE. Costs incurred for research purposes, over and above usual patient care, shall not be includable as allowable costs.
- B. APPLICATION. If research is conducted in conjunction with and as part of the care of patients, the costs of usual patient care shall be allowable to the extent that costs are not met by funds provided for the research. Under this principle, studies, analyses, surveys, and related activities to serve the facility's administrative and program needs shall not be excluded as allowable costs.

363. GRANTS, GIFTS AND INCOME FROM ENDOWMENTS

363. GRANTS, GIFTS, AND INCOME FROM ENDOWMENTS

A. PRINCIPLE. Unrestricted grants, gifts, and income from endowments shall not be deducted from operating costs in computing reimbursable cost. Grants, gifts, or endowment income designated by a donor for paying specific operating costs shall be deducted from the particular operating cost or group of costs.

B. DEFINITIONS.

1. Unrestricted Grants, Gifts and Income From Endowments. Unrestricted grants, gifts, and income from endowments are funds, cash or otherwise, given to a facility without restriction by the donor as to their use.
2. Designated or Restricted Grants, Gifts, and Income From Endowments. Designated or restricted grants, gifts, and income from endowments are funds, cash or otherwise, which shall be used only for the specific purpose designated by the donor. This does not refer to unrestricted grants, gifts, or income from endowments which have been restricted for a specific purpose by the facility.

363. GRANTS, GIFTS AND INCOME FROM ENDOWMENTS

363. GRANTS, GIFTS, AND INCOME FROM ENDOWMENTS

C. APPLICATION

1. Unrestricted funds, cash or otherwise, are generally the property of the provider to be used in any manner its management deems appropriate and shall not be deducted from operating costs. It would be inequitable to require providers to use the unrestricted funds to reduce the payments for care. The use of these funds is generally a means of recovering costs which are not otherwise recoverable. However, any interest earned on these funds shall be subject to the interest offset provisions of this manual.

2. Donor-restricted funds which are designated for paying certain operating expenses shall apply and serve to reduce these costs or groups of costs and benefit all patients who use the services covered by the donation. If costs are not reduced, the facility would secure reimbursement for the same expense twice; it would be reimbursed through the donor-restricted contributions as well as from patients and the Medicaid Program.

Page 363.02

364. VALUE OF SERVICES OF NONPAID WORKERS

364. VALUE OF SERVICES OF NONPAID WORKERS

- A. PRINCIPLE. The value of services performed on a regularly scheduled basis by persons (in positions customarily held by full-time employees) as non-paid workers under arrangements without direct remuneration from the provider shall be allowed as an operating expense for the determination of allowable cost subject to limitations contained in paragraph (B) of this section. The amounts allowed shall not exceed those paid others for similar work. Amounts shall be identifiable in the records of the facilities as a legal obligation for operating expense. Non-paid workers hired under arrangements with a Cabinet for Health Services authorized work experience program shall qualify for the purposes of the principles in this section.
- B. LIMITATIONS - SERVICES OF NON-PAID WORKERS. The service shall be performed on a regular, scheduled basis in positions customarily held by full-time employees and necessary to enable the provider to carry out the functions of normal patient care and operation of the facility. The value of services of a type

Page 364.01

TN # 96-10

Supersedes

TN # 90-6Approved MAY 16 2001Eff. Date 7-1-96

364. VALUE OF SERVICES OF NONPAID WORKERS

364. VALUE OF SERVICES OF NONPAID WORKERS

for which facilities generally do not remunerate individuals performing these services shall not be allowed as a reimbursable cost under the Medicaid Program.

For example, donated services of individuals in distributing books and magazines to patients, or in serving in a facility canteen or cafeteria or in a facility gift shop shall not be reimbursed.

- C. APPLICATION. The following illustrates how a facility shall determine an amount to be allowed under this principle: The prevailing salary for a lay nurse is \$5,000 for the year. The lay nurse receives no maintenance or special perquisites. A nun working as a nurse engaged in the same activities in the same facility receives maintenance and special perquisites which cost the facility \$2,000 and are included in the facility's allowable operating costs. The facility may then include in its records and additional \$3,000 to bring the value of the services rendered to \$5,000. The amount of \$3,000 shall be allowed if the facility assumes obligation for the expense under a written agreement with the sisterhood or other religious order covering payment by the facility for the services.

365. PURCHASE DISCOUNTS AND ALLOWANCES, AND REFUNDS OF EXPENSES

365. PURCHASE DISCOUNTS AND ALLOWANCES AND REFUNDS OF EXPENSES

- A. PRINCIPLE. Discounts and allowances received on purchases of goods or services are reductions of the costs to which they relate. Similarly, refunds of previous expense payments are reductions of the related expense.
- B. DEFINITIONS.
1. Discounts. Discounts, in general, are reductions granted for the settlement of debts.
 2. Allowances. Allowances are deductions granted for damage, delay, shortage, imperfection, or other causes, excluding discounts and returns.
 3. Refunds. Refunds are amounts paid back or credits allowed because of overcollections.
- C. NORMAL ACCOUNTING TREATMENT - REDUCTION OF COSTS. All discounts allowances, and refunds of expenses are reductions in the cost of goods or services purchased and are not income. When they are received in the same accounting period in which the purchases were made or

365. PURCHASE DISCOUNTS AND ALLOWANCES, AND REFUNDS OF EXPENSES

365. PURCHASE DISCOUNTS AND ALLOWANCES AND REFUNDS OF EXPENSES

expenses were incurred, they shall be used to reduce the purchases or expenses of that period. However, if they are received in a later accounting period, they shall be used to reduce the comparable purchases or expenses in the period in which they are received.

366. COST TO RELATED ORGANIZATIONS

366. COST TO RELATED ORGANIZATIONS

- A. PRINCIPLE. Cost applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includable in the allowable cost of the provider and is the cost of the related organization. However, the cost shall not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere.
- B. DEFINITIONS.
1. Related to Provider. Related to the provider means that the provider, to a significant extent, is associated or affiliated with, or has control of, or is controlled by the organization furnishing the services, facilities, or supplies.
 2. Common ownership. A relationship shall be considered to exist when an individual, including husband, wife, father, mother, brothers, sisters, sons, daughters, aunts, uncles, and in-laws, possesses five (5) percent or more of ownership or equity in the facility and the supplying business. A relationship shall also be

366. COST TO RELATED ORGANIZATIONS

366. COST TO RELATED ORGANIZATIONS

considered to exist when it can be demonstrated that an individual or individual's control or influence management decisions or operations of the facility and the supplying business.

3. Control. Control exists if an individual or an organization has the power, directly or indirectly, to significantly influence or direct the actions or policies of an organization or facility.

- C. APPLICATION. If the provider obtains items of services, facilities, or supplies from an organization, even though it is a separate legal entity, and the organization is deemed to be a related organization, in effect the items are obtained from itself. Reimbursable cost shall include the cost for these items at the cost to the supplying organization. However, if the price in the open market for comparable services, facilities, or supplies is lower than the cost to the supplier, the allowable cost to the provider shall not exceed the market price. An example would be a corporation building a nursing home and then leasing it to another corporation controlled by the owner.

366. COST TO RELATED ORGANIZATIONS

366. COST TO RELATED ORGANIZATIONS

- D. EXCEPTION. An exception is provided to this general principle if the provider demonstrates by convincing evidence to the satisfaction of the Department for Medicaid Services that the supplying organization is a bona fide separate organization; that fifty-one (51) percent of the supplier's business activity of the type carried on with the facility is transacted with persons and organizations other than the facility and its related organizations and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization; that the services, facilities, or supplies are those which commonly are obtained by facilities such as the provider from other organizations and are not a basic element of patient care ordinarily furnished directly to patients by facilities; and that the charge to the provider is in line with the charge for services, facilities, or supplies in the open market and not more than the charge made under comparable circumstances to others by the organization for services, facilities, or supplies. In cases, the charge by the supplier to the facility for services, facilities, or supplies shall be allowable as cost.

367. DETERMINATION OF ALLOWABLE COST OF SERVICES, SUPPLIES AND
EQUIPMENT

367. DETERMINATION OF ALLOWABLE COST OF SERVICES, SUPPLIES, AND
EQUIPMENT

A. PRINCIPLE. Reimbursement to providers for services, supplies and equipment shall be based on reasonable allowable cost as defined in this section.

Reimbursement for the services of physicians is detailed in Section 369 of this manual.

B. DETERMINING ALLOWABLE COST. The allowable cost of services, supplies and equipment shall not exceed the lowest of:

1. The acquisition of cost the provider;
2. The provider's usual and customary charge to the public;
3. The prevailing charge in the locality as determined by Medicare the Department for Medicaid Services as applicable; or
4. If the item or service is identified in the Federal Register as one which does not vary significantly in quality from one supplier to another, the lowest charge level as defined in CFR 450.30.

368. COST RELATED TO PATIENT CARE

368. COST RELATED TO PATIENT CARE

- A. PRINCIPLE. All payments to facilities shall be based on the reasonable cost of covered services and related to the care of recipients. Reasonable cost includes all necessary and proper costs incurred in rendering the services, subject to principles relating to specific items of revenue and cost. However, payments to facilities shall be based on the lesser of the reasonable cost of covered services furnished to Medicaid Program recipients or the customary charges to the general public for such services.
- B. Reasonable cost of any services shall be determined in accordance with the principles of reimbursement establishing the method or methods to be used, and the items to be included. These principles take into account both direct and indirect costs of facilities. The objective is that under the methods of determining cost, the costs with respect to individuals covered by the Medicaid Program shall not be borne by individuals not so covered, and the costs with respect to individuals not so covered shall not be borne by the Medicaid Program.

Page 368.01

TN # 96-10

Supersedes

TN # 90-6Approved MAY 16 2001Eff. Date 7-1-96

369. REIMBURSEMENT FOR SERVICES OF PHYSICIANS

369. REIMBURSEMENT FOR SERVICES OF PHYSICIANS

- A. PRINCIPLE. If the physician bills the patient directly, such amount is to be approved and paid in accordance with the established practices relating to the physician element of the Medicaid Program. If the physician does not bill the patient directly, costs to the facility are recognized as indicated in paragraph (C) of this section.
- B. REASONABLE COST. For the purposes of determining reasonable costs of services performed by physicians employed full time or regular part-time, reasonable cost of the services shall not exceed what a prudent and cost-conscious buyer would pay for comparable services by comparable providers.

369. REIMBURSEMENT FOR SERVICES OF PHYSICIANS

369. REIMBURSEMENT FOR SERVICES OF PHYSICIANS

C. APPLICATION. If the physician is compensated by the facility for medical consultations, etc., on a part-time basis, the amounts paid to the physician, if reasonable, shall be recognized by the Medicaid Program as an allowable cost. Physician services by a part-time facility employee for medically necessary direct patient services shall be paid the physician directly through the physician's element of the Medicaid Program. If the physician is a full-time employee of a nursing facility, all reasonable costs including direct patient services, shall be recognized as routine facility costs and shall not be billed to the Medicaid Program directly by the physician.